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China, Peoples Republic of

Trade Policy Monitoring

China's VAT on Domestic and Imported

Agricultural Products Unequal

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Report Highlights: Chinese regulations covering VAT prescribe a collection process that results in a VAT rate on domestic agricultural products significantly lower than on the same imported products. For field crops, the maximum effective VAT on domestic products appears to be 9 percent. For feed grains sold directly to feed mills the effective maximum rate is only 4.5 percent. Imports of these commodities face a 13 percent VAT.

Includes PSD changes: No
Includes Trade Matrix: No
Unscheduled Report
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In response to complaints from exporters, post has examined China's 1993/1994 State Administration of Tax regulation titled "The Temporary Regulation for the Value Added Tax (VAT)" (full text available in Chinese at <http://mof.gov.cn>; relevant sections translated in Appendix starting paragraph 12 below). This is the current law covering the implementation of China's VAT. This law treats imported and domestic agricultural commodities differently because of the special manner in which China applies the VAT to producers of primary agricultural products.

In China, as in a large number of other countries, rather than charging a consumption or sales tax at the final point of sale, a value-added tax (VAT) is assessed at each transaction point. In the jargon of the tax code, this VAT shows up on the seller's receipt as a "sales VAT" and on the buyer's receipt as a "purchase VAT." The tax collector collects the difference between the "sales VAT" and the "purchase VAT" shown on business receipts.

However, China treats "products sold by agricultural producers" differently than other products. Specifically, Article 16, Item 1 of the regulation, stipulates that these products are VAT free. The Ministry of Finance maintains that this exemption is justified because it would be impractical for Chinese farmers, often poorly educated and with very small land holdings, to keep track of "purchase VATs" and "sales VATs".

This exemption creates a problem because the VAT paid by farmers on inputs is not accounted for and consequently the value added represented by these inputs would be charged a VAT a second time at the next transaction point. In order to compensate for this problem, the VAT law, in Article 8, Item 3, allows buyers of products from farmers to claim 10 percent of these products' value as a purchase VAT.

The following is an example to clarify the problem. A farmer sells a ton of corn to a trader for RMB 900. The trader in turn sells that corn for RMB 1,000 to a feed mill. The farmer writes the trader a receipt for RMB 900. However, the trader would write a receipt to the feed mill for RMB 1,000 plus a (13 percent x RMB 1,000) = RMB 130 VAT. The trader has "sales VAT" of RMB 130 and can claim a "purchase VAT" equal to 10 percent of the corn value. The tax collector therefore collects RMB 130 - RMB 90 (i.e. 10 percent x 900 RMB) or RMB 40. This mechanism implies that the farmer paid 10 percent of the corn's value or RMB 90 in VAT on the purchase of inputs.

However, such a large implied VAT bill for farmers is difficult to defend. National Bureau of Statistics input/output data suggest this to be an exaggeration. On major Chinese field crops the ratio of the value of material inputs (i.e. everything besides land, labor and taxes) to output value is on average 1 to 3, or 33 percent. Corn has the highest ratio at 39 percent. However, at least one quarter, and probably many more, of these inputs do not carry a VAT. Seed, irrigation fees, and most fertilizers are VAT free. Therefore, it is fair to say that, at most, VAT-able inputs account for 30 percent of the value of farmers' field crop revenues.

Applying this 30 percent standard, and assuming that inputs are charged the maximum 17 percent VAT, this would mean that the actual VAT paid by farmers for field crops is at most (17 percent of 30

percent) or approximately 5 percent of the value of output. In the example given above, the farmer would actually have paid RMB 45 or less for VATs on inputs. To compensate for farmers' VAT payments, traders should be allowed to claim at most a "purchase VAT" equal to 5 percent, not 10 percent, of the corn's value. This means that the VAT collected should be RMB 130 - RMB 45 or RMB 85.

Therefore, in practice the Chinese tax system is not collecting the full RMB 130 or 13 percent that should be assessed on corn delivered to feed mills. Instead it is collecting only the RMB 40 noted above, plus, at most, RMB 45 in VAT paid by the farmer. Thus, the effective tax is less than 8.5 percent, not the 13 percent on the books. This general case can be made for all Chinese field crops. Assuming, as in this example, an 11 percent mark-up for marketing costs, the maximum VAT actually collected on Chinese field crops is 8.5 percent. Even if one generously assumes marketing costs of 25 percent, the maximum VAT collected is only 9 percent.

Field crop imports like corn, soybean, wheat and rice, in contrast with products purchased from domestic agricultural producers, do not receive this break. Under Article 15, the Government assesses a VAT on all imports equal to the VAT rate times landed price plus any applicable consumption tax. For these commodities import purchases are assessed a straight 13 percent VAT paid directly to customs. Therefore, domestic products appear to be receiving at least a 4 percent break on the VAT.

The domestic advantage is even greater for corn or other feed grain that feed mills purchase directly from farmers. In this case, which probably accounts for the majority of non-government purchases, the feed mills' outputs are VAT free as well. In such cases, the Government only collects the VAT paid by farmers on inputs. Assuming 11 percent for marketing costs, this means that the Government collects at most 4.5 percent of the feed grain's value, not 8.5 percent as in the general case. For a 25 percent mark-up, it collects only 4 percent. Meanwhile, imported feed grain still draws a 13 percent VAT, meaning that imported corn appears to face more than an 8 percent price disadvantage because of the VAT.

Appendix:

The following is an unofficial English translation of relevant portions of China's 1993/1994 State Administration of Tax Regulation titled "The Temporary Regulation of the VAT."

Article 2.

Item 2. The VAT rate for taxpayers selling or importing the following goods shall be 13 percent.

Part 1. food grains, edible oils

Part 4. feed grains, fertilizer, pesticides, agricultural machinery, agricultural film

Article 4. The "payable VAT" is equal to the "sales VAT" minus the "purchase VAT."

Article 5. The "sales VAT" is the VAT collected by sellers from buyers when selling goods or providing services. "Sales VAT" equals the sale value multiplied by the VAT rate.

Article 8.

Item 1. The "purchase VAT" is the VAT paid by buyers when purchasing goods or receiving payable services.

Item 2. Except for items in 3 (below), the amount of the "purchase VAT" subtracted from the "sales VAT" shall be in accordance with the amount listed on the following documents:

- A. VAT payment listed on the sales receipt provided by the seller;
- B. VAT payment listed on the tax receipt issued by China Customs.

Item 3. Buyers purchasing VAT free agricultural products are allowed a "purchase VAT" reduction. The "purchase VAT" shall equal 10 percent of the purchase price.

Article 15. When tax payers import goods, the "payable VAT" is calculated according to the following formulas:

- A. "Price for tax" equals clearance price plus tariff plus consumption tax
- B. "Payable tax" equals "price for tax" multiplied by the "VAT rate"

Article 16. The following commodities are VAT free.

Item 1. Products sold from agricultural producers.

The following is the relevant portion of the 1993/1994 "Implementation Procedures for the Temporary Regulation of VAT."

Article 31. The concept and scope indicated by Article 16, Item 1 of the VAT regulation is as follows: Agriculture includes planting, livestock, pasture, forestry, and fishery. Agricultural producers indicate both individuals or organizations handling agricultural production. Agricultural products indicate primary agricultural products and the specific scope is determined by local taxation bureaus directly under the State Taxation Bureau.